**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**Telecommunications Division** **RESOLUTION T-16904**
**Market Structure Branch** **December 16, 2004**

# R E S O L U T I O N

**Resolution T-16904. Verizon California Incorporated (U-1002-C). Request for Approval of Price Cap Mechanism, In Compliance with Decision 89-10-031 and Decision 94-09-065, and Corresponding Adjustments to Surcharges which will be Effective on January 1, 2005.**

**By Advice Letter No. 10,966 Filed on October 1, 2004.**

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## Summary

This Resolution authorizes Verizon California, Inc. (Verizon) to decrease its annual revenues by $19,000,000 effective January 1, 2005. The adopted revenue adjustments and surcharge changes are shown in Appendices A and B attached to this resolution.

Verizon requested an annual revenue decrease of $19,000,000 due to the impacts of a one-time limited exogenous (LE) factor adjustment for a compliance adjustment for the GTEC / Bell Atlantic Merger Revenue Reduction. While the annual revenue decrease of $19 million is the same as in last year’s price cap resolution, Verizon’s billing base is smaller than the one in the 2004 price cap resolution. Therefore, the effect of Verizon’s proposal will lead to larger surcredits in 2005 than in bills in 2004. Customers will, therefore, pay less for service in 2005 than in 2004.

## Background

In Decision (D.) 89-10-031 the Commission adopted an incentive-based regulatory framework (called the new regulatory framework or “NRF”) for SBC Telephone Company (formerly known as Pacific) and Verizon California Incorporated (formerly known as GTE California Incorporated or GTEC). The decision stated that prices and rate caps would be indexed annually according to the Gross National Product Price Index (GNP-PI) inflation index reduced by a productivity adjustment.

The indexing formula allowed rate adjustments for a limited category of exogenous factors, called Z-factors, whose effects are not reflected in the GNP-PI. Only specific types of costs were considered Z-factors: changes in federal and state tax laws to the extent they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes, and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.

However, the Commission did not authorize Z-factor treatment for all unforeseen or exogenous factors. In D.89-10-031, the Commission stated that normal costs of doing business (including costs of complying with existing regulatory requirements) or general economic conditions would be excluded as Z-factor items.

The price cap indexing formula has been modified since being adopted in D. 89-10-031. In D.93-09-038, the Commission ordered GTEC to replace the GNP-PI with the Gross Domestic Product Price Index (GDP-PI), and in D.94-09-065, the Commission authorized Pacific and GTEC to implement the 1995 price cap rate adjustments through the billing surcharge / surcredit mechanism.

In 1995, the Commission issued D.95-12-052 regarding the second triennial New Regulatory Framework review and suspended the application of the GDP-PI minus productivity factor formula used in price cap regulation of Pacific and GTEC.

In October 1998, the Commission issued D.98-10-026 regarding the third triennial review of the NRF. The order continues the suspension of the GDP-PI minus productivity factor formula, suspends for the first time the sharing mechanism, permanently eliminates the depreciation review, replaces Z-factors with limited exogenous (LE) factors, and continues rate caps on residential services by keeping all rate caps and floors.

The order also specifies that, in the future, LE cost recovery is confined to recovery for cost increase or decreases resulting from (1) items mandated by the Commission and (2) changes in total intrastate recovery resulting from changes between federal and state jurisdiction. Recovery of Commission mandated cost changes must be authorized in the underlying Commission Decision.

The Commission opened the fourth triennial review of NRF for SBC and Verizon on September 6, 2001 via a combined Order Instituting Rulemaking 01-09-001 and Order Instituting Investigation 01-09-002. Phase 1 of the review focused on a regulatory audit of Verizon that addressed accounting, cost allocation, affiliate transactions and Yellow Pages directory ratemaking issues. Policy issues, such as the price cap indexing mechanism, are expected to be addressed in the upcoming Phase 3 of the review.

## Verizon's Price Cap Filing

On October 1, 2004, Verizon California Inc. filed Advice Letter No. 10966 requesting billing surcredit changes to be effective January 1, 2005 in order to implement the one-time revenue adjustments for 2005.

Verizon California Inc.'s filing requests the following revenue adjustment.

1. **GTE-Bell Atlantic Merger Compliance Adjustment**
   Per D.00-03-021, the former GTE California Inc. which is now known as Verizon California Inc. must include an annual rate reduction of $19.0 million per year for five years beginning with the first NRF price cap filing made after consummation of its merger with Bell Atlantic.

Verizon California requests a total revenue reduction of $19.00 million to become effective on January 1, 2005, that reflects the GTE-Bell Atlantic merger compliance adjustments ordered in D.00-03-021. Verizon used an annualized billing base of $1,687,754,000 for calculating the surcredit effective January 1, 2005.

## Notice/Protest

Verizon California Inc. stated that a copy of the advice letter was mailed to interested utilities and/or parties. Notice of Advice Letter No. 10966 was published in the Commission Daily Calendar on October 8, 2004.

No protests were filed.

## Discussion

### GTE-Bell Atlantic Merger Compliance

In D.00-03-021 (OP 1.b), Verizon (formerly GTE California Inc.) was directed as follows.

"GTE California, or its successor, shall reduce its annual revenues by $19.0 million per year for five years. GTE California, or its successor, shall include this revenue reduction in the first October 1 new regulatory framework price cap advice letter filing made after consummation of the merger. GTE California, or its successor, shall include this revenue adjustment in each October 1 price cap advice letter filing for a total of five years. Each price cap advice letter shall specify, among other things, the billing base for the purpose of this surcredit. The billing base shall include local, toll and access revenues, with the billing base incorporating the amount of both the CHCF-B and the annual total revenues from residential exchange service access charges. The billing base shall be updated with each price cap advice letter".

The Telecommunications Division (TD) finds that Verizon California Inc.'s price cap filing complies with Ordering Paragraph 1 in D.00-03-021, and recommends adoption of the $19.0 million revenue reduction ordered in the decision. The filing also identified the billing base used for the merger surcredit for the 2004 price cap filing. The billing base includes local, toll and access revenues.

## Impact of Adopted Changes

For the year 2004, Verizon was required to refund to customers $19.0 million due to the impacts of a one-time limited exogenous (LE) factors adjustments. The $19.0 million revenue reduction adopted here is the same as adopted in last year's price cap resolution. However, Verizon's billing base has decreased, therefore, the surcredit on customer bills will be higher as shown in Appendix B of this resolution. The effect of the higher surcredit is that customers will pay slightly less for telephone service in 2005 than they paid in 2004.

**Price Floors:**

In reviewing Verizon's tariffed prices against the price floors, TD observed that Verizon had services in which the tariffed price was below the price floor. Verizon explained that approximately 90% of these services are tied up in the Open Access Network Architecture Development (OANAD) proceeding which will set new price floors. Verizon stated that the other 10% of the services are "obsolete" services and if there are any customers using these services, they will be contacted and suggested a newer appropriate service for them.

With this explanation, TD finds Verizon's requested price floors to be reasonable and recommends that they be adopted.

To coordinate specific services having tariffed prices below the price floor, Verizon shall report to TD within 30 days of the effective date of this resolution with:

- a list of the services that will be effected by the OANAD proceeding and
- a list of the "obsolete" services along with the number of customers on those services and status of moving those customers to newer services.

**Section 311 Comments:**

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to P.U.Code Section 311(g) (2), the otherwise applicable 30-day period for public review and comment is being waived.

## Findings

1. Verizon filed Advice Letter No. 10966 on October 1, 2004 to implement Verizon's 2005 price cap mechanism and a revenue adjustment. Verizon requested adjustments for the GTE-Bell Atlantic merger.

2. The Bell-Atlantic merger savings refund identified by Verizon in compliance with D.00-03-021 is reasonable and should be adopted.

3. A total price cap mechanism decrease of $19.0 million is reasonable and should be made effective January 1, 2005.

4. Verizon's requested price floors are reasonable and should be adopted.

5. For those services in which the tariffed rate is below the price floor, Verizon shall report to TD within 30 days of the effective date of this resolution:
   - a list of the services that will be effected by the OANAD proceeding and
   - a list of the "obsolete" services along with the number of customers on those services and status of moving those customers to newer services.

**THEREFORE, IT IS ORDERED** that:

1. Verizon California, Inc. shall reduce its annual revenues by $19.00 million as a result of its 2005 annual Price Cap Adjustment filing in Advice Letter No. 10966.

2. Verizon California, Inc. shall implement billing surcredits reflecting the revenue decrease ordered in Paragraph 1, applied to a total billing base of $1,687,754,000 for intraLATA access services, intraLATA exchange and private line services, and intraLATA toll services, to become effective on January 1, 2005, subject to review and approval by the Telecommunications Division.

3. The revisions to Verizon California, Inc's price floors filed in Advice Letter No. 10966 are adopted and shall be implemented on January 1, 2005.

4. For those services in which the tariffed rate is below the price floor, Verizon shall report to TD within 30 days of the effective date of this resolution:
   - a list of the services that will be effected by the OANAD proceeding and
   - a list of the "obsolete" services along with the number of customers on those services and status of moving those customers to newer services.

This Resolution is effective today.

I hereby certify that the Public Utilities Commission adopted this Resolution at its regular meeting on December 16, 2004. The following Commissioners approved it:

/s/ STEVE LARSON

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

APPENDIX A
Resolution T-16904

Verizon California, Inc.
2005 Price Cap Filing
$ (in Millions)

| | Verizon Proposed Revenue Impacts | Adopted Impacts |
|---|---|---|
| Ongoing Adjustments | | |
| GTE-Bell Atlantic Merger Compliance | $ (19.00) | $ (19.00) |
| Permanent LE Factor | none | none |
| | | |
| One-Time Other Adjustments | none | none |
| | | |
| | | |
| Total | $ (19.00) | $ (19.00) |

APPENDIX B
Resolution T-16904

Verizon California, Inc.
2005 Price Cap Filing
(Adjustments by %)

| | Verizon Existing Surcredit | Verizon Proposed Surcredit | Adopted Surcredit |
|---|---|---|---|
| Access | (4.13%) | (4.22%) | (4.22%) |
| Local | (1.14%) | (1.23%) | (1.23%) |
| Toll | (3.32%) | (3.41%) | (3.41%) |